No. 230

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JOHN T. FEY, Clerk

In the Supreme Court of the United States

October Term, 1956.

OMAHA PUBLIC POWER DISTRICT, a public corporation and political subdivision of the State of Nebraska, WESTERN IOWA POWER COMPANY, a corporation, IOWA POWER AND LIGHT COMPANY, a corporation, and OMAHA ELECTRIC COMMITTEE, INC., a corporation,

Petitioners,

VS.

GEORGE W. O'MALLEY, Collector of Internal Revenue for the United States Internal Revenue District of Nebraska.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE EIGHTH CIRCUIT.

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vs.

GEORGE W. O'MALLEY, Collector of Internal Revenue for the United States Internal Revenue District of Nebraska.

No.....

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE EIGHTH CIRCUIT.

Petitioners above named respectfully pray that a writ of certiorari issue to review the judgment of the United States Court of Appeals for the Eighth Circuit entered in the above entitled case on May 3, 1956.

Opinion Below.

The opinion of the United States District Court, not officially reported, is set forth in the record herein, p. 80. The opinion of the Court of Appeals (R. App.) is reported in 232 F. 2d 805, and is appended hereto.

Jurisdiction.

The judgment of the Court of Appeals was entered on May 3, 1956. The jurisdiction of this Court is invoked under Section 240(a) of the Judicial Code as amended by the Act of February 13, 1925.

Question Presented.

The question presented is whether section 116(d) of the Internal Revenue Code of 1939 exempts from federal income tax income derived from a public utility by a corporation, all of the stock and securities of which are owned by a political subdivision of a state.

Statutes Involved.

The applicable statute is section 116(d) of the Internal Revenue Code of 1939, 26 U. S. C. §116(d), which provides:

> In addition to the items specified in section 22(b), the following items shall not be included in gross income and shall be exempt from taxation under this chapter:
>
> * * * * * * *
>
> (d) Income of States, Municipalities, etc.—Income derived from any public utility or the exercise of any essential governmental function and accruing to any State, Territory, or the District of Columbia, or any political subdivision of a State or Territory, or income accruing to the government of any possession of the United States, or any political subdivision thereof.
>
> Whenever any State, Territory or the District of Columbia, or any political subdivision of a State or Territory, prior to September 8, 1916, entered in good faith into a contract with any person, the object and purpose of which is to acquire, construct, operate, or maintain a public utility—
>
> (1) If by the terms of such contract the tax imposed by this chapter is to be paid out of the

proceeds from the operation of such public utility, prior to any division of such proceeds between the person and the State, Territory, political subdivision, or the District of Columbia, and if, but for the imposition of the tax imposed by this chapter, a part of such proceeds for the taxable year would accrue directly to or for the use of such State, Territory, political subdivision, or the District of Columbia, then a tax upon the net income from the operation of such public utility shall be levied, assessed, collected and paid in the manner and at the rates prescribed in this chapter, but there shall be refunded to such State, Territory, political subdivision, or the District of Columbia (under rules and regulations to be prescribed by the Commissioner with the approval of the Secretary) an amount which bears the same relation to the amount of the tax as the amount which (but for the imposition of the tax imposed by this chapter) would have accrued directly to or for the use of such State, Territory, political subdivision, or the District of Columbia, bears to the amount of the net income from the operation of such public utility for such taxable year.

(2) If by the terms of such contract no part of the proceeds from the operation of the public utility for the taxable year would, irrespective of the tax imposed by this chapter, accrue, directly to or for the use of such State, Territory, political subdivision, or the District of Columbia, then the tax upon the net income of such person from the operation of such public utility shall be levied, assessed, collected, and paid in the manner and at the rates prescribed in this chapter.

STATEMENT.

The facts as stipulated (R. 54) and found by the United States District Court (R. 81) are as follows:

Acquisition of the properties of Nebraska Power Company (hereinafter referred to as "Nebraska Power") by the Omaha Public Power District (hereinafter referred to as "the Omaha District"), was the final step in an established program for the conversion to public ownership of all the electric utilities in the State of Nebraska. That program, started prior to 1933 and fostered in that year by the Nebraska Legislature by the enactment of legislation authorizing the creation of public power districts to acquire, own and operate such facilities, had been brought to near completion by the end of 1943 by four public power districts organized under such statutory authority, including Loup River Public Power District and Consumers Public Power District (hereinafter referred to respectively as "Loup" and "Consumers"). By that time all of the power facilities in the State, other than those owned by Nebraska Power, were owned either by those Districts or by municipalities, all of which were political subdivisions of the State of Nebraska (R. 54-55).

The facilities of Nebraska Power served the City of Omaha, Nebraska, and its surrounding territory, and the city of Council Bluffs, Iowa, and its environs. All of its outstanding common stock was owned or under option to American Power Company (R. 56). In 1942, Consumers made a public offer to American Power Company to purchase all of the assets or the common stock of Nebraska Power (R. 55). That offer was refused, but in August of that year the Securities and Exchange Commission of the United States directed American Power Com-

pany to terminate and dissolve under the supervision of the Commission (R. 57). The effort of Consumers to acquire the properties of Nebraska Power aroused a group of citizens of Omaha who were opposed to the acquisition of the properties by any district not controlled within the geographical limits of the area served by Nebraska Power (R. 55).

Accordingly, the Mayor of Omaha appointed an informal committee to investigate the possibility of the acquisition in some manner of the properties of Nebraska Power by the city. Their efforts failed, however, because the investment bankers and insurance companies whom they approached for financial assistance required that the obligations to finance the purchase of the facilities be issued by a public agency. The committee did not want to create a district under the existing statutory provisions which provided that the governing body of such a district be elected and who thus would be subject to political influences (R. 56).

They therefore sponsored the enactment by the Legislature of the "Peoples Power Commission Law" (Ch. 36, Laws of Nebraska, 1943, p. 156), which authorized the Governor and Mayor to appoint a commission to acquire and operate the power facilities, and prohibited acquisition of the properties by any of the outstate districts (R. 57). An Omaha Commission was duly created under that law, but before it could accomplish anything, it was restrained from further action by court injunction (R. 58).

In order to avoid a possible loss of the advantage presented by the order of the Securities and Exchange Commission directing American Power Company to dissolve, which would be lost if the properties of Nebraska Power should be sold before the validity of the Peoples Power Commission Law should be determined, a group consist-

ing of five who had been members of the Peoples Power Commission of Omaha and three who had not, formed a committee known as the Power Committee. That Committee then employed Guy C. Myers, who had assisted Consumers in acquiring all of the other privately owned electric utilities in Nebraska, to work out a plan by which the stock or properties of Nebraska Power could be purchased and financed (R. 58).

The plan which resulted was to finance purchase of the common stock of Nebraska Power with obligations of Loup, with legal title to the stock to vest temporarily in a nonprofit corporation for a maximum period of approximately three years during which time either a suitable public agency could be established in the Omaha area through the validation of the powers of the Omaha Peoples Power Commission or by the enactment of legislation for the creation of a public power district acceptable to the people of Omaha, or legislation could be obtained to authorize direct ownership of the properties of Nebraska Power by Loup, Loup to agree that at the end of the three-year period it would buy the properties of Nebraska Power lying within the State of Nebraska for a price sufficient merely to discharge any obligations which were a lien on the properties, and the nonprofit corporation to agree that it would transfer such properties and either the Iowa properties or the proceeds thereof to either the public agency in Omaha or to Loup. Following this plan there was organized a nonprofit corporation ultimately known as Omaha Electric Committee, Inc. (hereinafter referred to as "the Electric Committee"), and by means of the issuance of bonds by Loup, through its Eastern Division, purchase of the common stock of Nebraska Power was financed and carried out (R. 59-62).

The sole purpose of the Electric Committee was to act as the temporary medium by which the electric system

of Nebraska Power could be acquired and transferred to a political subdivision of Nebraska. To that end, it executed an agreement with Loup, declaring its public trust enforceable by Loup, the Omaha Peoples Power Commission, the City of Omaha, the State of Nebraska, and any Omaha citizen, and bound itself to convey the properties either to a public agency in the Omaha area or to Loup (R. 62-63). As promptly as possible after the acquisition of the stock, its articles of incorporation were amended to eliminate any possibility that the properties be held otherwise than in public ownership and to insure the ultimate vesting of the ownership and operation of the properties in the city of Omaha or another Nebraska public body (R. 63-65).

In August, 1945, Omaha Public Power District (hereinafter referred to as the "Omaha District") was formed (R. 65). Its legality was forthwith contested in litigation, but by the fall of 1946 this litigation was finally concluded in its favor, and it was in position to operate as a public utility and political subdivision of the State of Nebraska (R. 66).

It is at this point that the case at bar begins, but the foregoing historical background is submitted to explain the origin of the Electric Committee and the function it performed in the events which then ensued.

The first action of the Omaha District was to make arrangements for the operation of the Iowa properties of Nebraska Power. In *State* v. *Consumers Public Power District*, 143 Nebr. 753, 10 N. W. 2d 784, 795, the Supreme Court of Nebraska had in dictum indicated that the Nebraska Public Power Districts had only limited authority to own properties in other states (R. 66). Accordingly, at the direction of the Omaha District, the Electric Committee caused the incorporation of Western Iowa Power

Company (hereinafter referred to as "Western Iowa") to hold for the benefit of the Omaha District the Iowa assets other than those in an area west of the Missouri River (R. 66-71), and the Electric Committee, by agreement with the Omaha District, confirmed the public trust in which the Electric Committee held all of its assets, including the securities which it had obtained from Western Iowa (R. 71-72). The Nebraska assets of Nebraska Power were then transferred directly to the Omaha District (R. 71).

An effort was then made to interest the city of Council Bluffs, Iowa, which was the only public body concerned, in acquiring the Iowa facilities (R. 72). Failing that, the securities of Western Iowa were sold to a privately owned utility. At the conclusion of that sale, the proceeds thereof, including the amounts derived from the operation of the Iowa properties during the period in which they were beneficially owned by the Omaha District, together with all other assets then in the hands of the Electric Committee, were finally transferred to the Omaha District (R. 72-76).

The District Court held (R. 81-82), that the sole question presented was whether the income of Western Iowa *accrued* to the Omaha District, a political subdivision of the State of Nebraska. The court stated that if it were a case of first impression, the court might be inclined to say that the income so accrued, but upon the authority of a decision of the Court of Appeals for the Ninth Circuit in *Bear Gulch Water Co.* v. *Commissioner*, 116 F. 2d 975, the reasoning of which the court found to be in keeping with the interpretation of section 116(d) which had been given by the Court of Appeals for the Eighth Circuit in *Citizens Water Co.* v. *Commissioner*, 87 F. 2d 874

and *City of Burlington* v. *United States,* 148 F. 2d 887, the court determined that petitioners' complaint should be dismissed. The Court of Appeals affirmed (R. App.).

Specification of Errors To Be Urged.

The Court of Appeals erred:

1. In holding that income derived by a corporation from a public utility would accrue to the owner of all of the outstanding stock of such corporation only to the extent that a dividend were declared.

2. In holding that the income of Western Iowa Power Company was not exempt from Federal income taxes under section 116(d) of the Internal Revenue Code of 1939.

3. In holding that contemporaneous interpretation of a statute by officials charged with its administration is of no significance in determining its meaning.

4. In affirming the decision of the United States District Court.

REASONS FOR GRANTING THE WRIT.

I.

The Decision of the Court Below Is in Conflict with Decisions of the United States Court of Appeals for the First Circuit and the Court of Claims.

Section 116(d) of the Internal Revenue Code provides in pertinent part as follows:

> In addition to the items specified in section 22(b), the following items shall not be included in gross income and shall be exempt from taxation under this chapter:
>
> * * * * * * *
>
> (d) Income of States, Municipalities, etc.—Income derived from any public utility * * * and

accruing to any * * * political subdivision of a State or Territory * * *.

Whenever any * * * political subdivision of a State or Territory, prior to September 8, 1916, entered in good faith into a contract with any person, the object and purpose of which is to acquire, construct, operate, or maintain a public utility—

> (1) If by the terms of such contract the tax imposed by this chapter is to be paid out of the proceeds from the operation of such public utility, prior to any division of such proceeds between the person and the * * * political subdivision * * *, and if, but for the imposition of the tax imposed by this chapter, a part of such proceeds for the taxable year would accrue directly to or for the use of such * * * political subdivision * * *, then a tax upon the net income from the operation of such public utility shall be levied, assessed, collected and paid in the manner and at the rates prescribed in this chapter, but there shall be refunded to such * * * political subdivision * * * (under rules and regulations to be prescribed by the Commissioner with the approval of the Secretary) an amount which bears the same relation to the amount of the tax as the amount which (but for the imposition of the tax imposed by this chapter) would have accrued directly to or for the use of such * * * political subdivision * * * bears to the amount of the net income from the operation of such public utility for such taxable year.

It will be observed that the first paragraph of this statutory provision exempts income derived from a public utility all of which accrues to a state or its political sub-

divisions. The second paragraph provides for a refund of tax to a state or political subdivision in certain cases where the state or political subdivision owns only a portion of a utility or of the stock of a corporation operating the utility. In appropriate circumstances it authorizes a refund of the tax upon the income which would have accrued directly to the state or political subdivision but for the imposition of the tax.

Section 116(d) traces its origin to Section II G(a) of the Revenue Act of 1913 (The Tariff Act of October 3, 1913), c. 16, 38 Stat. 114. That section contained a provision corresponding with the first paragraph of section 116(d) which was carried forward through all subsequent revenue statutes and into the Internal Revenue Code without material change. The provision in the 1913 Act which was the forerunner of the second paragraph of section 116(d) was contained in a proviso to section II G(a) which provided as follows:

> *Provided*, that whenever any State, Territory, or the District of Columbia, or any political subdivision of a State or Territory, has, prior to the passage of this Act, entered in good faith into a contract with any person or corporation, the object and purpose of which is to acquire, construct, operate or maintain a public utility, no tax shall be levied under the provisions of this Act upon the income derived from the operation of such public utility, so far as the payment thereof will impose a loss or burden upon such State, Territory, or the District of Columbia, or a political subdivision of a State or Territory; but this provision is not intended to confer upon such person or corporation any financial gain or exemption or to relieve such person or corporation from the payment of a tax as provided for in this section upon the part or portion of the said income to which such person or corporation shall be entitled under such contract.

This provision gave rise to administrative difficulties, however, because there was no way to provide for exemption of the portion of the income of a corporation which inured to the benefit of the state or political subdivision without conferring a benefit upon the private shareholders. Accordingly, in section 213 (b)(7) of the Revenue Act of 1924, c. 234, 43 Stat. 253, the second paragraph was amended to read substantially as it now provides. This, however, was merely a procedural change (Senate Report No. 398, 68th Cong. 1st Sess., 1939-1 Cum. Bul. [Part 2] 266, 282) to require payment of the tax by the corporation with a refund to the public body of the amount of tax allocable to its share of the corporation's earnings. Thus, in this second paragraph, it is apparent that the words "would have accrued" were intended to prescribe the same test as the prior provision requiring the showing only of the imposition of a loss or burden upon the public body.

Manifestly, the Congress did not intend a *narrower* exemption to apply to those cases falling under the first paragraph of the statute when the state or political subdivision owned all of the stock of a corporation operating a public utility than it intended to apply in cases where the state or political subdivision owned only a part of the stock. Thus, by the exemption of income "accruing to" a political subdivision, it clearly intended to exempt income inuring to the benefit of the political subdivision, upon which the imposition of the tax would cause a loss or burden to the political subdivision.

In this statutory setting, we turn to consideration of the courts' construction of the statute.

The present case involves the first paragraph of the section by reason of the fact that the Omaha District owned all of the outstanding stock and securities of West-

ern Iowa through the medium of the express trust under which such stock and securities were held by the Electric Committee for the benefit of the Omaha District. The income of Western Iowa was therefore exempt from Federal income tax if, within the meaning of section 116(d), such income accrued to the Omaha District even though it had not been declared as a dividend by Western Iowa. The Court of Appeals construed the words "accruing to" in the sense of requiring an enforceable obligation and hence, it held that the exemption would apply only to such part of the income as was actually declared as a dividend.

A squarely contrary conclusion was reached by the Court of Appeals for the First Circuit in *Jamestown and Newport Ferry Company* v. *Commissioner,* 41 F. 2d 920. In that case the question before the court was whether the income of the Ferry Company was subject to the federal income tax. The facts involved were that the City of Jamestown, located on Conanicut Island in Narragansett Bay, Rhode Island, was predominately a summer resort and prior to 1837 it was in need of water transportation connecting it with Newport and the mainland. The city agreed to subscribe to 60% of the stock of a ferry company to be organized, upon the condition that private capital take the remainder. In May of 1873, the Jamestown and Newport Ferry Company was incorporated by special act of the Rhode Island Legislature with an authorized capital of $100,000 and it was given an exclusive right to carry passengers and freight from Jamestown to Newport. Sixty per cent of its capital was furnished by Jamestown and 40 per cent by individuals. In 1923, the town loaned the Ferry Company $100,000 secured by a mortgage. The Ferry Company furnished the only means of transportation between Jamestown and Newport and with the mainland, except for transportation furnished by small private boats.

For the fiscal years ended in 1922, 1923 and 1925, the Commissioner of Internal Revenue determined deficiencies against the Ferry Company and he was sustained by the Board of Tax Appeals. In reaching this decision, the Board reasoned (16 B.T.A. 638, 650) that a stockholder is not entitled to any part of the income of a corporation until the income has been set apart by proper corporate action; and upon this premise, finding that no part of the ferry company's income had been declared as a dividend, it concluded that no part of the income accrued to Jamestown within the meaning of the statute, just as the court of appeals in the instant case has concluded. Appeal was taken to the Circuit Court of Appeals for the First Circuit where the board's decision was reversed. The court stated that the questions were "whether the ferry company's income, or at least that portion thereof which the stock owned by Jamestown bears to the total stock outstanding" was exempt from federal income tax under section 213(b)(7) of the Revenue Acts of 1921 and 1924 and the court held that those statutory provisions applied.

Jamestown and Newport Ferry Company was not itself a political subdivision of the state of Rhode Island nor did its income accrue as an enforceable claim to Jamestown. It did, however, inure to the benefit of Jamestown which was a political subdivision of the state and the court held that that fact was sufficient to bring the income within the exemption of the statute. Thus the court clearly held that the word "accrue" should be construed in the sense of inuring to the benefit of rather than in the sense of giving rise to an enforceable claim. The interpretation of the statute by the Court of Appeals in the present case is in direct conflict with that holding.

A like conclusion was reached by the Court of Claims in *City of Galveston, Texas* v. *United States*, 10 F. Supp.

810, cert. den. 297 U. S. 712, with which the decision herein is likewise in conflict.

Therein Galveston Wharf Company operated wharves, docks and terminal facilities at the port of Galveston, Texas. The city of Galveston claimed ownership of one-third of the properties being used and operated by the wharf company and after lengthy litigation the dispute was settled by compromise, and an agreement was entered into pursuant to which there were issued to the city 6,222 shares of a total of 18,666 shares of the stock of the wharf company then outstanding. The agreement confirmed in the city an undivided one-third interest in the property and stated that such interest "shall be represented by said city's 6,222 shares of the stock" and also that "said city shall be entitled to and shall receive dividends from the said Galveston Wharf Company in the same manner in which such dividends have heretofore been paid; that is, said city shall be entitled to and shall receive upon each of the 6,222 shares of stock the same amount of dividends as shall be paid by the said Galveston Wharf Company on any other share of stock."

Subsequently, for services and other property acquired by the corporation, it issued 7,600 additional shares, bringing the total outstanding shares to 26,266.

The corporation regularly filed income tax returns and ultimately paid a tax upon all of its net income for the years 1920 to 1928, inclusive. For the years 1929 and 1930, however, it deducted one-third of its net earnings as representing the city's interest and paid tax on the balance. The Commissioner disallowed these deductions and determined deficiencies for the years 1929 and 1930 and also, as a result of other adjustments, determined deficiencies for the prior years, all of which the company paid, with interest. No part of the payments were re-

covered by the corporation. The city, however, filed claims for refund for the years 1920 to 1930, inclusive, in each of which it claimed that one-third of the wharf company's income was exempt from taxation and that the tax paid thereon should be refunded to the city.

The Commissioner rejected the claims for refund of taxes paid for the years 1920 to 1923, inclusive, in toto, on the ground that prior to the enactment of the Revenue Act of 1924 the city had no right to maintain a suit for refund of any taxes paid by the wharf company. He allowed the claims and refunded 6222/26,266ths of the fourth installment of the taxes reported by the company for the year 1924 and the same percentage of all of the taxes it reported for the years 1925 to 1930, inclusive, together with a like proportion of the deficiencies and interest it paid for all of those years. He refused to refund any portion of the first three installments of the taxes paid for 1924 on the ground that such refunds were barred by the statute of limitations. The city instituted suit in the Court of Claims to recover one-third of the taxes paid for the years 1920 to 1923, inclusive; and one-third of the first three installments of the 1924 tax. On the ground that it actually owned one-third of the properties operated by the wharf company the city also sought to recover the difference between 6222/26,266ths and one-third of the taxes paid (a) as the fourth installment of the 1924 tax, (b) for the years 1925 to 1930, inclusive, and (c) as deficiencies. The Court of Claims sustained the action of the Commissioner with respect to the taxes paid for all years prior to 1924 on the ground that prior to the enactment of the Revenue Act of 1924 the wharf company, and it only, had a right to file and prosecute a claim for refund of taxes paid by it and that the city of Galveston had no such right. It sustained the

Commissioner's action in allowing a refund of only 6222/26,266ths of the fourth installment and the deficiency paid for the calendar year 1924 and of the taxes paid for the calendar years 1925 to 1930, inclusive. However, it reversed the Commissioner's disallowance of any refund of the first three installments of the taxes paid for the year 1924 and allowed a refund of 6222/26,266ths of those installments, which fraction represented the tax imposed on that part of the income which inured to the benefit of the city by virtue of its ownership of the stock in the corporation.

The court's findings of fact show that for the year 1924, the city's proportionate share of the corporation's net income before deducting federal income taxes was $69,862.09, which would allocate to it $61,139.29 after taxes, compared with aggregate dividends of $31,110.00 paid to it that year. For subsequent years the earnings retained by the company were as great or greater than the amount retained in 1924. Manifestly, therefore, the whole of the portion of the income of the Galveston Wharf Company allocable to the city's share did not accrue as an enforceable claim to the city but both the Commissioner and the Court of Claims agreed that it did inure to the benefit of the city and that that was sufficient to require a refund to the city of that portion of the tax which was allocable to the income which inured to it by virtue of its stockholding in the wharf company.

Thus it can be seen that there exists a conflict of decisions upon the proper construction of this statutory section and it is respectfully submitted that that conflict should be resolved by this Court.

II.

The Principles of Statutory Construction Applied by the Court of Appeals were in Conflict with Applicable Decisions of this Court.

The principal issue in the case being the proper interpretation of a federal statute which undeniably is ambiguous, it is an established principle of this Court that the contemporaneous construction of the statute by the officers charged with its administration should be accorded great weight. *Fawcus Machine Co.* v. *United States,* 282 U. S. 375; *Commissioner* v. *South Texas Lumber Co.,* 333 U. S. 496; and see also *Augustus* v. *Commissioner,* 6 Cir., 118 F. 2d 38, cert. den. 313 U. S. 585. In their brief before the Court of Appeals, petitioners showed that the 1918 edition of Treasury Department Regulations 33, promulgated on January 2, 1918, clearly set forth the contemporaneous administrative construction of the statute. In the index to those regulations, page 187, we find the following:

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Public utilities whose income *inures* to benefit of State	313
When income so *inures* in part only	450

(Italics added.)

and, in Article 68, page 51 (par. 313), it is said:

> "Among the corporations exempt from the tax without condition, are * * * public utilities whose income *inures* to the benefit of any state, Territory, or political subdivision thereof." (Italics added.)

The Court of Appeals, however, determined that the fact that the 1918 Regulations used the word "inures" has little bearing upon the construction of the statute because that regulation remained in effect for only one year and

similar language does not appear in either prior or subsequent regulations.

It is true that in the first edition of Regulations 33, promulgated on January 5, 1914, under the 1913 Act, the provisions of the statute were merely paraphrased without interpretation. Article 84 of Regulations 45, promulgated under the Revenue Act of 1918, returned to a mere paraphrase of the first paragraph of the statute and with respect to the second paragraph provided that in "the case of a public utility acquired, constructed, operated or maintained by a taxpayer under contract with any State, Territory, or political subdivision thereof, or with the District of Columbia, containing an agreement that a portion of the net earnings of such public utility shall be paid to the State, Territory or political subdivision thereof, or the District of Columbia, the amount so paid may be deducted by the taxpayer as a necessary expense in transacting business." This regulation was carried forward into Article 87 of Regulations 62, promulgated under the Revenue Act of 1921, but in Articles 87 of Regulations 65 and 69 and Articles 642 of Regulations 74 and 77, promulgated respectively under the Revenue Acts of 1924, 1926 and 1928 and 1932, the first paragraph of the section of the statute was merely paraphrased and all reference to the second paragraph was deleted. Regulations 86, promulgated under the Revenue Act of 1934, and all subsequent regulations have omitted any reference to subsection (d) of section 116. Thus it can be seen that the first definitive interpretation of the statute by the Treasury Department construed the statute as meaning "inuring to the benefit of" and that interpretation was never affirmatively changed. It follows that the contemporaneous construction of the statute in Regulations 33 has a very important bearing upon the

meaning of the statute and disregard of it by the Court of Appeals was in direct conflict with decisions of this Court on this important principle of statutory construction.

III.

There is Presented Herein an Important Question of Federal Law Which Has Not Been and Which Should be Passed upon by This Court.

We further submit that there is presented herein a question which has not been and which should be passed upon by this Court by reason of the fact of the confusion existing in its interpretation in the lower courts as well as confusion in its interpretation and application by the Commissioner of Internal Revenue and because the decision of the Court of Appeals has a serious effect upon Federal-state relations with respect to public utility operations of the states and their political subdivisions and if followed by the Internal Revenue Service will seriously impede the efficient operation of publicly owned utilities.

It has been shown that divergent views upon the correct interpretation of the section now exist among the courts of appeals and the Court of Claims some of which exempt the income of a corporation operating a public utility only to the extent that a political subdivision of a state has an enforceable claim to such income while other courts have construed it to exempt income which inures to the benefit of the state or political subdivision. In addition to the cases heretofore referred to, the Court of Appeals for the Ninth Circuit in *Bear Gulch Water Company* v. *Commissioner*, 116 F. 2d 975, held that the income of the water company, all of the stock of which was owned by the Board of Regents of the University of California, a political subdivision of the State of Cali-

fornia, was not exempt under section 116(d) by reason of the fact that that statute exempted income of a corporation wholly owned by a political subdivision of a state only to the extent that the income was actually declared as dividends. A third position was taken by the District Court of the United States for the District of Pennsylvania in *Philadelphia Rapid Transit Co.* v. *United States*, 8 F. Supp. 152, in which the court held that the exemption applied only to income which was actually received by the state or political subdivision.

The Commissioner of Internal Revenue is likewise uncertain of the proper interpretation of the section. As has been shown above in the 1918 edition of Regulations 33, the statute was construed as using the word "accruing" in the sense of "inuring to the benefit of." The same view was expressed in Office Decision 328, 1 Cum. Bul. 93, wherein the Commissioner held that the section operated to exempt income derived by a corporation operating a public utility in a town which "owns practically all of the common stock, upon which no dividends are to be paid." We next find that in Solicitors Memorandum 2941, IV-1 Cum. Bul. 210, published in 1925, the provisions of the first paragraph of the section were attempted to be limited to a case where a city operates a utility as its own activity and not through the medium of a corporation. In General Counsel's Memorandum 14407, XIV-1 Cum. Bul. 103, published in 1935, in which General Counsel for the Department of the Treasury was considering whether the income tax should be imposed upon a commercial activity directly carried on by a state, the purpose and meaning of section 116(d) were considered and the following statement appears (page 105):

> In the entire period since the enactment of the Tariff Act of 1913, the Bureau has regularly con-

> sidered section 116(d) and the corresponding provisions of prior Revenue Acts from the standpoint of the taxability of corporations owned by, or operating under contract with, States or municipalities.

Further, it was stated (p. 106) that the Committee Reports and debates on the floor of Congress preceding the passage of the 1913 Act make it clear that what Congress was concerned with was "that part of the income derived by a corporation from the public utility business or from the performance of a governmental function which would accrue to a State or a municipality by virtue of its possession of a 'beneficial interest' in the corporation."

Again, we find in the case of *City of Galveston, Texas* v. *United States, supra,* that the Commissioner conceded that income for the years 1924 to 1930, inclusive, derived from the operation of a public utility by a corporation of which part of the stock was owned by the city was exempt to the extent of the city's proportionate stock interest. Finally, notwithstanding his position in the instant case that the income of Western Iowa, all of which inured to the benefit of the Omaha District, was not exempt from tax, in Rev. Rul. 54-296, 1954-2 Cum. Bul. 59, published on August 2, 1954, the Commissioner ruled as follows:

> Advice is requested regarding the treatment, for Federal income tax purposes of (1) a nonprofit corporation to be formed under the general corporation laws of the State for the purpose of converting certain municipally owned property to community use and (2) interest on the debenture notes to be issued by the corporation for the purpose of financing such improvements.
>
> A group of public spirited citizens feel that the city of M has pressing need of a structure suitable for general purposes, civic and recreational use such

as sporting events, various school functions and other municipal enterprises. Efforts have been made to get the city to convert certain of its municipally owned property into such a structure. However, due to many other demands for expenditures by the city for capital improvements of a very pressing nature, the city council has been reluctant to appropriate funds to effect such conversion.

It is proposed that a nonprofit corporation be formed to effect the desired improvements to the municipally owned property and that all of the capital stock of the corporation be issued to the city of M in exchange for a lease on the property, the lease to provide that at the end of its term or as soon as the indebtedness of the corporation is retired by it, or when the city assumes or discharges the outstanding debt of the corporation, whichever occurs first, the city would then become the absolute owner of the improvements.

Under the plan the funds necessary to make the improvements would be borrowed on debenture notes issued by the corporation, secured by a pledge of the net revenues from the rentals of the improved property, and the debt would be liquidated from the proceeds of operations over a period of approximately the length of the lease. None of the revenue will ever accrue to the benefit of any person, firm, or corporation, except to the city of M, whose only direct benefit would be the value of the improvements.

On the basis of the facts presented in this case, it is held that the income to be earned from the rentals of a municipally owned building, by a nonprofit corporation to be formed under the general corporation laws of the State by a group of public spirited citizens to effect desired improvements to such building, and which income will never accrue to the benefit of any person, firm or corporation except the municipality, will not be subject to Federal income tax.

Section 116(d) is the only statutory authority for such a ruling and manifestly the income of the corporaton did not "accrue" to the city in the form of an enforceable claim. It did inure to its benefit. Furthermore, under the interpretation of the Court of Appeals in the instant case, the income did "accrue to" the corporation involved.

Thus we find that there has been serious vacillation in the administrative interpretation of the statute and we also find that although in the case at bar the Commissioner is contending for a strict construction of the word "accrue," beginning with the earliest definitive interpretative regulations and continuing well beyond the date of the commencement of this action, the Commissioner continues to apply the statutory exemption to income which inures to the benefit of a political subdivision of a state. In view of such long standing indecision, we submit that the interpretation of section 116(d) should be settled by this Court.

Finally, although we have been unable to find any statistical compilation or other authoritative source which would show how widespread is the practice of employing a wholly-owned corporation to carry on the operations of municipally-owned utilities, it seems indisputable that there are many such corporations in existence. One reason is that the corporation affords a means of obtaining and compensating the executive personnel on a basis differing from that applied generally to the city employees. Another reason is to enable a city to avoid exceeding its debt limitations. Many cities are subject to a limitation upon the amount of indebtedness that can be incurred, and the enormous investment required for an electric utility is often beyond the financial ability of a city without a bonded indebtedness beyond the scope of the limit. Through the medium of a corporation for

whose obligations the city is not liable, such investment can be financed. If such corporate instrumentalities exist, as we know they must, it is apparent that the Internal Revenue Service would be duty bound to tax their income in order to preserve any semblance of uniformity of taxation, for it is obvious that the income of such corporations would not and could not be distributed as dividends to the city-shareholder.

Conclusion.

Wherefore, it is respectfully submitted that this petition for a writ of certiorari should be granted.

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